[redacted]

Yellow copy

Central Intelligence Agency

25X1

Washington D.C. 20505

DIRECTORATE OF INTELLIGENCE

15 January 1986

Japanese Policy toward the Aluminum Smelting Industry: Letting the Market Work [redacted]

25X1

Experts disagree over whether Japanese government policies toward the aluminum smelting industry have encouraged its adjustment to foreign competition or have provided protection to the ailing firms. In our view, neither argument provides a satisfactory description of the government's role in dealing with companies whose ability to compete against imported ingot has declined precipitously since the mid-1970s. We believe supply and demand conditions prevailing in Japan's aluminum ingot market over the last decade--rather than government policies--have had the greatest impact on the industry. Specifically, the combination of the energy intensive nature of aluminum smelting and Japanese electricity prices that are well above the international norm would have compelled Japanese smelters to shed capacity even if the government had not set forth goals to that end. Imports have risen sharply as a result of these domestic production cutbacks, although most have come from overseas smelters owned by Japanese firms. [redacted]

25X1

This memorandum was prepared by Japan Branch, Northeast Asia Division, Office of East Asian Analysis. Information available as of 15 January 1986 was used in its preparation. Comments and questions are welcome and may be directed to the Chief, Japan Branch, Northeast Asia Division, OEA, [redacted].

25X1

25X1

[redacted]

EA M 86-20001

[redacted]

25X1

[redacted]

25X1

Protection: An Overstated Argument

Japan's Fair Trade Commission is among those who allege that government policies targeted at declining industries like aluminum smelting are protectionist. This characterization of the programs in place since 1978 is technically correct, but we believe it overstates the case (see Figure 1). In our view, Tokyo has refrained from taking steps that could have insulated the smelting industry from market forces much more effectively in its time of troubles. For example, the government could have imposed quotas or high tariffs on ingots or could have granted generous subsidies to smelters that would have wiped out the cost advantage enjoyed by foreign producers of primary aluminum. Although some Japanese industry officials have advocated such action, the programs actually implemented have been much less sweeping.

foreign pressure is one reason that Tokyo opted for a relatively restrained approach. We also believe the relatively limited political clout of the proponents of protection for the industry helped restrain official policy:

-- The aluminum smelting industry is not a large employer--4300 people in August 1982--compared with other depressed Japanese industries, such as cotton spinning, which employed 61,000 in 1982. As a result, its spokesmen face a problem in making a strong "jobs" pitch for special protection from foreign imports.

-- The politicians representing districts where smelters are located, who are most naturally inclined to protect ingot producers, are either not very powerful or are not particularly interested in the aluminum smelting industry. For example, the record of Seiichi Kataoka, a fifth-term Dietman from the Nakasone faction who represents the Toyama district that includes a Sumitomo plant, primarily reflects his concerns with agriculture and Sino-Japanese relations.

-- The pro-protectionist bureaucrats in MITI face internal opponents, who do not want to help the smelters if the step hurts the larger and more technologically-sophisticated aluminum fabricating industry. The Finance Ministry also is routinely shooting down any relief proposals that require more than token amounts of government money.

Adjustment: A Weak Argument

MITI's portrayal of its policies as nothing more than inducements for the industry to face reality and abandon

Figure 1

Key Japanese Government Programs for Aluminum Smelting Industry

Program	Implemented	Features
Offical loans	1978	Provides low-cost loans for new technologies, more energy efficient plant and equipment, and disposal of excess smelting capacity
Light Metal Stockpile Association	1976 (Expired 12/85)	Set up to purchase excess aluminum ingot from domestic smelters (see Figure 4 for additional details)
Tariff quota system	1978	Grants smelters a preferential tariff (currently 1 percent) on imported ingot in exchange for reductions in domestic smelting capacity. [redacted]
Tax benefits	1983	Allows smelters to carry forward losses incurred when equipment scrapped; on approved investments, grants special depreciation allowances in first year

25X1

25X1

[redacted]

25X1

uneconomical production capacity, in our view, is equally unpersuasive. Implicit in MITI's argument is the assumption that political or economic roadblocks stand in the way of the smelting industry's adjustment to its decreased competitiveness. We do not see evidence of either. The nature of the international aluminum market and the structure of the Japanese industry make it likely that cutbacks in capacity will be sharp and quick, even without government "help":

-- Differences among products and their quality play almost no role in decisions to purchase primary aluminum, making the prices sellers charge crucial. High electricity rates in Japan have made the cost, and therefore the price, of Japanese aluminum ingot out of line with that produced in countries such as Australia and the United States. For the last five years, domestically produced ingots have cost Japanese consumers approximately 150,000 yen ($600) more per ton than imported products. Stagnant demand in the Japanese primary aluminum market has intensified price competition in recent years (see Figure 2).

-- Aluminum smelters in Japan are not as a rule part of vertically integrated companies, denying ingot producers the option of persuading in-house fabricators to buy their high-priced goods. Only one Japanese aluminum company--Nippon Light Metal Company--is vertically integrated. The others belong to industrial groups that contain aluminum fabricators and rollers, but the links between these companies are too weak to provide the ingot producers with captive customers (see Figure 3).

-- To date, Japanese aluminum producers have chosen to scrap capacity because of their inability to find purchasers for their high-priced ingots. Japanese smelters had only two other choices: to stockpile production they could not sell or to reduce capacity utilization rates.[1] The first two options are acceptable short-run solutions, but they are too costly to be maintained for long. Capacity stood at 1.64 million tons per year in 1978, when government relief measures began; today it stands at 712,000 tons. Even at this reduced level, capacity utilization was below 50 percent.

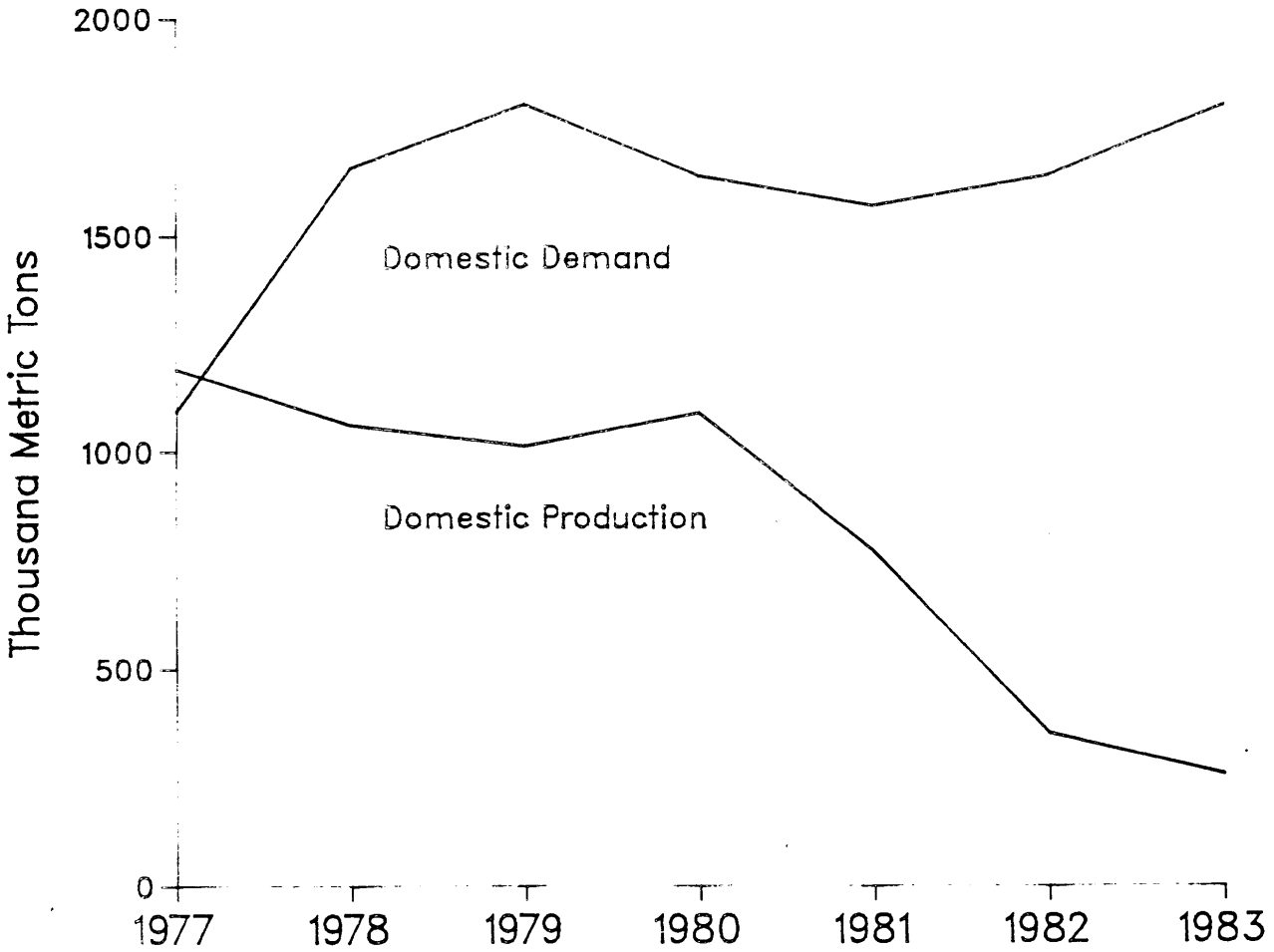
Captive Imports Surge

As domestic aluminum smelting capacity and production have fallen, imports have soared. In 1977--before the government implemented its relief program--imports filled 11 percent of

[1] For additional information on official stockpiling programs, see Figure 4.

Figure 2

Japan: Primary Aluminum Production and Demand



25X1

Figure 3

Japan's Aluminum Smelting Industry: A Profile

Company	Nippon Light Metal Co.	Sumitomo Aluminum Smelting	Showa Keikinzoku	Mitsui Aluminum	Ryoka Light Metal Industries*
1981 Sales ($Million)	1300	900	600	300	500
1981 Employees	6800	2400	1500	800	1200
Parent Company	Alcan	Sumitomo Chemical	Showa Denko		
Industrial Group	DKB–Furukawa	Sumitomo	Fuyo	Mitsui	Mitsubishi
Aluminum Fabricators in Group	Furukawa Aluminum Co.	Sumitomo Light Metal Industries Nitto Aluminum Mfg Co.	Showa Aluminum	Mitani Shindo Co. Ltd.	Mitsubishi Aluminum
Site of Aluminum Smelters	Kanbara	Toyama	Chiba	Miike	Sakaido

*Formerly Mitsubishi Light Metal Company

25X1

Figure 4

Japanese Aluminum Stockpiles
(million metric tons)

	Producer	LMSA*	Retail	Total
1977	288	10	31	329
1978	188	22	37	247
1979	90	0	15	105
1980	231	0	48	279
1981	308	22	N.A.	N.A.
1982	197	N.A.	N.A.	N.A.
1983	119	146	N.A.	N.A.
1984	124	N.A.	N.A.	N.A.
1985	116 (Sept.)	116 (Oct.)	N.A.	N.A.

* MITI approved the establishment of the Light Metal Stockpile Association (LMSA) in 1976. LMSA, like two other nonprofit associations responsible for stockpiling nonferrous metals, is financed through nominal subscriptions from member firms, direct and indirect government subsidies for interest rates, and government guarantees on loans provided by city banks. Trade journals report that MITI approval is required for all transactions and is granted under the following conditions

--For purchases: Refiners' inventories of primary aluminumum must be at least 150 percent above monthly demand.

--For sales: Three years after purchase, if not sold otherwise, the sellers must repurchase at not less than the purchase price (including carrying charges).

In October 1985 MITI decided to disband LMSA, effective December 1985. This forced Japanese smelters to buy back about $240 million of ingots held in stock.

25X1

25X1

Japanese aluminum ingot demand. In 1984, they filled 60 percent (see Figure 5). US firms have benefited some from the rise, but most of the increased imports have come from countries where Japan has invested in smelters (see Figure 6). Officials in Tokyo have blessed the growth of "captive imports" from overseas smelters projects and provided financing for projects in Brazil and Indonesia.

Nonetheless, we believe that captive imports would have risen as domestic smelter capacity fell even without government involvement:

-- Industry experts point out that fluctuating demand, the small number of traders involved, and opportunism make reliance on the international spot market risky. To avoid this risk, most aluminum users have opted to fill their ingot needs domestically, through long-term contracts, or by investing in offshore smelting capacity. Prior to the mid-1970s, this last option was ruled out for Japanese companies because government policies discouraged the export of capital. Japanese firms, therefore, relied heavily on long-term contracts to fill their ingot import needs.

-- Japanese purchasers of aluminum continue to rely as little as possible on the spot market. Because of liberalized capital export policies, however, output from Japanese-owned offshore smelters is replacing long-term contracts as the source of most imports.

25X1

If the domestic smelting capacity continues to dwindle, we expect Japanese firms will seek additional captive sources of imports. Australia is a likely location for new projects, but sites in the United States may also be chosen.

25X1

25X1

Will (Tokyo Let) the Industry Die?

25X1

The Japanese Government has already countenanced the loss of 1.3 million tons of aluminum ingot production capacity and with it, the elimination of more than 3000 smelting jobs. But public statements raise questions about how much further Tokyo is willing to let the domestic industry contract.

25X1

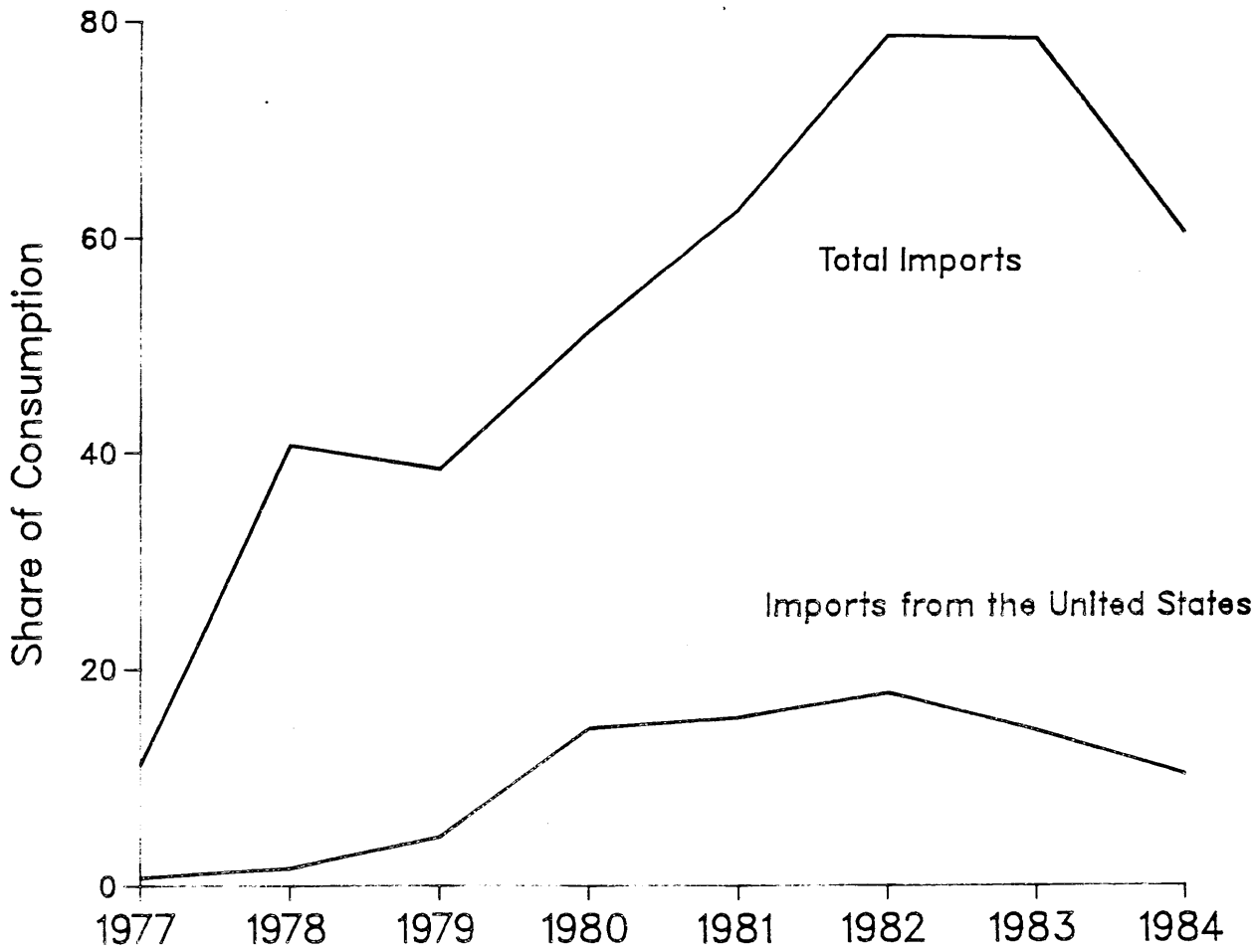
25X1

25X1

25X1

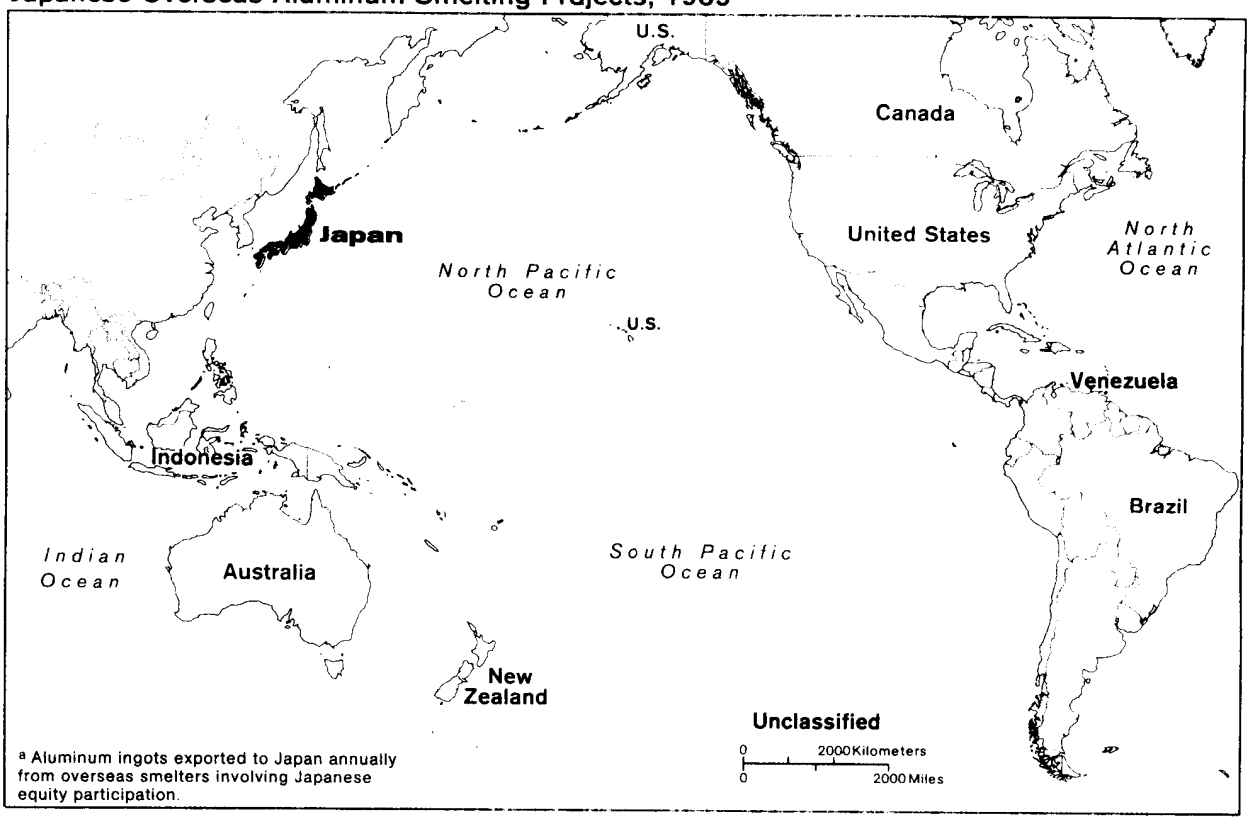
Figure 5

Japan: Primary Aluminum Consumption



25X1

Japanese Overseas Aluminum Smelting Projects, 1985[a]



[a] Aluminum ingots exported to Japan annually from overseas smelters involving Japanese equity participation.

Country	Project Name	Quantity (metric tons)
Australia	Gladstone	100,000
Brazil	Albras	30,000
Canada	Alpac	45,000
Indonesia	Asahan	160,000
New Zealand	NZAS	100,000
United States	Mt. Holly Alumax	45,000
Venezuela	Venalum	160,000

706822 (A05203) 1-86

[redacted] 25X1

[redacted] 25X1

[redacted] Industry 25X1
analysts believe the two smelters that do not rely on electricity generated from oil are internationally competitive. The production capacity of these two plants is 200,000 tons, suggesting that no new protectionist measures are necessary to address national security concerns. Indeed, recent actions by Tokyo--dismantling of a government subsidized aluminum stockpiling scheme and pledges to lower tariffs on ingots to zero by FY88--reveal a willingness to remove some of the protection now accorded the industry. [redacted] 25X1

[redacted] 25X1

25X1

SUBJECT: Japanese Policy toward the Aluminum Smelting Industry: Letting the Market Work

25X1

Distribution

Original - Joseph Massey, Assistant Trade Rep for Japan, USTR
1 - D/OEA
1 - DDI
1 - C/NEA
1 - C/Korea Branch
1 - C/STI Branch
6 - Japan Branch
1 - C/Research
1 - Senior Review Panel
5 - CPAS/IMC/CG

25X1

DDI/OEA/NEA/Japan/ 15 January 1986

25X1

25X1